



City of Houston, Texas

*Report to Management for the
Year Ended June 30, 2003*

December 23, 2003

The Honorable Mayor, Members of
City Council and City Controller
of the City of Houston, Texas

In planning and performing our audit of the basic financial statements of the City of Houston, Texas (the "City") for the year ended June 30, 2003 (on which we have issued our report dated December 23, 2003), we considered its internal control in order to determine our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the City's internal control. However, we noted a certain matter involving the City's internal control and its operation that we consider to be a reportable condition under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the City's internal control that, in our judgment, could adversely affect the City's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements. The reportable condition that we noted is summarized below.

Finding: The City's financial reporting process does not appear to be adequate in order to ensure that nonroutine accounting transactions are being properly captured and recorded by the City.

Background: Due to the City's diverse operations, there are a number of complex accounting and financial reporting transactions that are entered into each year. The City was required to record a number of auditor proposed adjustments including restatements of the June 30, 2002 basic financial statements for a number of unrelated accounting and financial reporting items. Included within these audit adjustments and restatements were items related to capital assets, pensions, accrued liabilities, deferred revenues and inventory. These adjustments relate to business-type activities in the City's enterprise funds as well as activities reported in the governmental funds.

Recommendations for corrective action: The City should evaluate its current financial accounting and reporting process. Within the evaluation there should be a critical review of the way in which financial information flows to and from departments and the City Controller's Office. The City should also evaluate the current financial accounting and reporting structure to assure that before the end of fiscal year 2004 there are adequate resources in place to limit the likelihood of future accounting errors.

Our consideration of the City's internal control would not necessarily disclose all matters in the City's internal control that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be material weaknesses. A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relation to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We believe that the reportable condition noted above is a material weakness.

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We also submit our comments concerning certain observations and recommendations relating to other accounting, administrative, and operating matters. These recommendations resulted from our observations made in connection with our audit of the City's financial statements for the year ended June 30, 2003. Our comments are presented in Exhibit II and are listed in the table of contents thereto.

This report is intended solely for the information and use of the Mayor, City Council, management, and others within the organization and is not intended to be and should not be used by anyone other than these specified parties.

We will be pleased to discuss these comments with you and, if desired, to assist you in implementing them.

Yours truly,

Deloitte & Touche LLP

CITY OF HOUSTON, TEXAS

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EXHIBIT I

MATERIAL WEAKNESS IN INTERNAL CONTROL— FINANCIAL ACCOUNTING AND REPORTING

Finding: The City's financial reporting process does not appear to be adequate in order to ensure that nonroutine accounting transactions are being properly captured and recorded by the City.

Background: Due to the City's diverse operations, there are a number of complex accounting and financial reporting transactions that are entered into each year. The City was required to record a number of auditor proposed adjustments including restatements of the June 30, 2002 basic financial statements for a number of unrelated accounting and financial reporting items. Included within these audit adjustments and restatements were items related to capital assets, pensions, accrued liabilities, deferred revenues and inventory. These adjustments relate to business-type activities in the City's enterprise funds as well as activities reported in the governmental funds.

Recommendations for corrective action: The City should evaluate its current financial accounting and reporting process. Within the evaluation there should be a critical review of the way in which financial information flows to and from departments and the City Controller's Office. The City should also evaluate the current financial accounting and reporting structure to assure that before the end of fiscal year 2004 there are adequate resources in place to limit the likelihood of future accounting errors.

Management Response: A separate group, Financial Reporting, has been reestablished within the Controller's Office and a Deputy City Controller has been hired to manage this group in an effort to ensure that all resources are maximized. The Financial Reporting staff will meet regularly with departmental personnel. This will give the Financial Reporting staff the opportunity to learn of any current or pending non-routine accounting transactions and to work with the departmental personnel on various accounting issues. Also, the Financial Reporting staff will review all City Council actions to ensure that financial information is known and, therefore, can be accounted for properly.

EXHIBIT II

OTHER ACCOUNTING; ADMINISTRATIVE AND OPERATING MATTERS

A. GRANTS FUNDS

Finding: A number of significant audit adjustments related to grant funds were required to be recorded during the 2003 audit for various items, including the following:

- Notes receivable balances that were recorded on the general ledger of the City had not been evaluated and written down to their appropriate balance as of year-end resulting in a material write-down of such balances;
- Notes receivables that should have been reflected on the City's general ledger were not included on the books of the City which resulted in such notes receivables having to be added to the general ledger for financial reporting purposes.

Recommendation: Departments responsible for grant management should investigate balances that are, or should be, reflected in the general ledger of the City to ensure that such balances are properly presented for financial reporting purposes.

Management Response: Notes receivable related to the down payment and closing cost assistance program are de facto grants to the recipients, with less than one percent, historically, requiring any amount of repayment. The year-end write-downs have been achieved, and safeguards are now in place to prevent a recurrence of the overstatements.

Corrections have been made to understand notes receivable items noted during the audit, and all balances will be regularly investigated to ensure that they are properly presented for financial reporting purposes.

B. COMPREHENSIVE INCLUSION OF ALL ACTIVITIES IN THE FINANCIAL STATEMENTS

Finding: Several instances were noted in which financial activity of the City was not recorded in the prior year's Comprehensive Annual Financial Report ("CAFR") or the original financial information prepared by the City for the current year CAFR.

Background: As a normal procedure the City creates funds to record and track the financial activity related to specific purposes. Certain of these funds were not reflected in the prior year CAFR nor in the fiscal year 2003 original working trial balances prepared by the City.

Recommendation: In order to prepare and report a complete set of financial statements, the City needs to identify and report all activities that should be included in the CAFR in accordance with guidance provided by the Governmental Accounting Standards Board ("GASB"). As new funds and / or activities of the City are added, the City needs to ensure that such activity is properly captured and reflected within the financial statements of the City.

Management Response: The Controller's Office has reconciled the funds appearing on the City's monthly A614 report, which lists all city funds, with the funds assigned to the fund holders. All funds have been accounted for and assigned to a specific fund holder. A final reconciliation will be performed using the A614 monthly report as of June 30, 2004 to insure that all funds are reflected in the Comprehensive Annual Financial Report.

C. INVENTORY

Finding: The City recorded inventory inconsistent with the City's existing stated accounting policy. These inconsistencies resulted in the prior year financial statements being restated as well as significant audit adjustments recorded in the current year. In addition, the City had not performed a reconciliation of the inventory subledger to the general ledger for the last two years.

Background: The City's stated accounting policy, which is in accordance with GASB guidance, is to report inventory under the consumption method of accounting at a government wide basis. At a fund level, it was noted that the City was recording some inventory balances under the consumption method and some balances under the purchase method.

Recommendation: Consistently apply the City's existing inventory policy. In addition, inventory should be monitored, tracked and reconciled to the general ledger to ensure that all inventory is being captured and properly reflected in the books and records of the City.

Management Response: The City's existing inventory policy is now consistently being applied on the consumption method. Inventory is being monitored and tracked monthly and will be reconciled at year-end to ensure that all inventory is being captured and properly reflected in the books and records of the City.

D. INVESTMENTS

1. Written Broker Confirmations

Finding: Several of the City's security brokers do not provide a written broker confirmation when the investment purchase is made.

Background: Written documentation of investment transactions should be obtained from any entity with which the City performs such trades. This information is necessary in order to provide an audit trail for documentation purposes.

Recommendation: Require all vendors that provide investment services for the City to provide written documentation of transactions.

Management Response: Every trade is documented in writing at the time of the trade. Available documentation varies by security and includes the following:

- Agency securities, mortgage backed securities and municipal securities are evidenced at the time of the transaction by the listing of the competitive offers received from which the selection was made, settlement amounts for the selected security, and the trade ticket received from the broker on the Bloomberg email system;
- Commercial paper is supported by the listing of the competitive offers received and settlement amounts for the selected security. Arrangements have been made to receive confirmation reports from the issuers for every purchase (this arrangement has now been put in place for Citigroup trades);
- Money market transactions are done strictly over the phone or Internet. The Internet transactions have a confirmation that is printed off the screen, but phone orders are documented solely by our wire sheets and the wire instructions on our Chase bank statement. Month-end statements are reviewed and reconciled to our records.

Beyond this documentation, the trend is away from printing written confirmation tickets and mailing the documents. Some clearinghouses are no longer supporting this step as an effort to move toward a paperless marketplace. They contend that control is at the clearing level since both sides of a transaction, the buyer and the seller, must send matching instructions in order for the exchange to be consummated. Where possible, the City will continue to file written documentation as it arrives, but the growing reliance on electronic systems is limiting the amount of paperwork available for our records.

2. Reconciliation of Investments

Finding: The City did not reconcile the balance of investments managed to the investments recorded at a fund level by approximately \$400,000 at June 30, 2003.

Background: The City manages its investments in a number of investment pools, in which the various funds of the City participate within. At June 30, 2003, the balance of the pooled investments exceeded the value of investments recorded at a fund level by approximately \$400,000. Certain funds were noted to be invested in multiple pools increasing the complexity of reconciling the funds to the pools.

Recommendation: Prepare a monthly reconciliation of the investments held by the City at a pooled level to investments recorded at a fund level to ensure that they are reconciled.

Management Response: A monthly reconciliation of the investments held by the City at the pool level to investments recorded at the fund level is now in place.

3. Market Value Adjustments

Finding: Market value adjustments were not performed consistently for all funds and not all funds within the City's books and records were subject to the market value adjustment, which resulted in a number of audit adjustments.

Background: The City maintains its investments at cost in the general ledger and therefore must record a manual adjustment at year end to properly value its investments at market in accordance with generally accepted accounting principles.

Recommendation: Ensure investments are calculated consistently among all funds and that all funds are properly included in the calculation.

Management Response: The Controller's Office will work to ensure that all funds are reviewed and the market value adjustments are made consistently.

4. Recording of Prior Year Market Value Adjustments

Finding: Market value adjustments recorded in the prior years were not properly reversed in the subsequent year.

Background: As the City maintains its investments at cost and records a market value adjustment at year end, it must also reverse the prior year's market value adjustment. In 2003, it was noted that a 2001 market value adjustment had not been properly reversed in 2002 resulting in an overstatement of investments and net assets in the prior year.

Recommendation: Ensure year end adjustments are reviewed and approved.

Management Response: Market value adjustments from prior years will be properly reversed. Senior staff will review and approve the market value adjustments before the reclassifications are posted on the Working Trial Balance.

E. CAPITALIZED INTEREST

Finding: Capitalized interest was miscalculated in one enterprise fund during the current and prior year and two other enterprise funds did not record capitalized interest in the current year. Capitalized interest was adjusted for and recorded in the restated financial statements for the fiscal year ended June 30, 2003.

Background: The recording of capitalized interest is required by generally accepted accounting principles in order to determine and record the inclusive cost of constructing capital assets.

Recommendation: Calculate and record capitalized interest for all enterprise funds in a consistent manner.

Management Response: The Aviation Department capitalized interest in accordance with a methodology that has been approved by our previous auditors, KPMG LLP, and which was based on the sample calculation in FASB Statement #62. The consolidation program, abnormally low interest rates and

delayed construction closeouts were not anticipated in the model's design and were causing inflated results. The Aviation department designed a revised methodology, and a restatement was recorded.

The Controller's Office is working with the other two enterprise departments to develop procedures that will ensure that capitalized interest is calculated and recorded in accordance with generally accepted accounting principles. These procedures will be applied consistently among the enterprise funds.

F. CAPITAL ASSETS

1. GFAMS System

Finding: The City is not consistently utilizing the information generated by the General Fixed Assets Management System ("GFAMS"), which is one of the City's capital asset subledger. Instances were noted in which capital asset information reflected in GFAMS was not being properly reflected in the appropriate fund's general ledger, and there were instances noted in which capital asset transactions were reflected in a funds general ledger, but were not properly reflected in GFAMS. As such, the prior year financial statements were restated for capital assets that were not properly supported by the subledger.

Background: There were instances noted in which some funds were not utilizing the information generated from GFAMS in order to ensure that the fund's financial statement information agreed and could be reconciled to GFAMS, which resulted in material adjustments being recorded during the course of the audit.

Recommendation: The City should perform a critical review of the information flowing in and out of the GFAMS system and how this information should be reconciled to the general ledger of all funds of the City.

Management Response: The City will implement training for all departments to ensure that capital assets are properly coded in the purchasing system and implement a regularly scheduled reconciliation process to ensure all capital assets are being booked and recorded properly.

2. Reconciliation of Capital Assets to Capital Asset Subledgers

Finding: The City's capital assets as of June 30, 2002 were overstated due to certain assets being reflected in two separate categories within the capital asset detail resulting in a material restatement to the June 30, 2002 financial statements.

Background: The City records capital assets in two systems – the GFAMS system and the Asset Information Management System ("AIMS"). For purposes of financial reporting, these two systems must be combined.

Recommendation: Establish checks and balances to ensure that the ending balance, once the two systems are combined, does not exceed the sum of the two systems.

Management Response: Finance & Administration (F&A) will work with both the Controller's Office and Public Works & Engineering (PWE) to ensure that procedures are developed and implemented to prevent overstating balances once the current two systems are consolidated by the Controller's Office.

3. Reconciliation of Capital Outlay to Capital Asset Additions

Finding: The City is required, under the provisions of GASB Statement No. 34, "Basic Financial Statements—and Management's Discussion and Analysis—for State and Local Governments", ("GASB No. 34"), to make adjusting entries related to capital outlay, which is expensed at a governmental fund level and capitalized at a government – wide level, in order to properly reflect the financial position of the City. Currently, the City does not have adequate processes in place to ensure that this reconciliation produces accurate and timely information.

Background: The City maintains certain accounts that are to be used to track expenses that relate to capital assets, however, such accounts are not being used exclusively for this purpose, which results in difficulty in reconciling expenses incurred in the current year to additions in capital assets.

Recommendation: The City should reevaluate current practices that are being utilized to capture and record capital asset information.

Management Response: F&A will coordinate with the Controller's Office to establish system changes that ensure all capital asset expenses are captured in a single account to enable a proper reconciliation process and prevent non-capital asset expenditures from being incorrectly reported. Changes to the system may not occur until replacement/purchasing of fixed asset applications are installed.

4. Improper Expensing of Capital Assets

Finding: Certain assets, including land and other equipment, were not properly reflected as capital assets in certain enterprise funds, but were expensed, which resulted in significant adjustments to the records of the City for the year ended June 30, 2003.

Background: The City expenses the purchases of capital assets in its enterprise funds and at year-end reverses these expenses to capital asset additions. The City has established accounts to track such purchases that are capital in nature, but the coding associated with these purchases is not being strictly adhered to. We noted instances in which the entire purchase order was being coded to such accounts without taking into consideration that only some of the purchases would qualify for capitalization.

Recommendation: The City should reevaluate current practices that are being utilized to capture and record capital asset information.

Management Response: PWE will ensure that purchased assets received will be reconciled to the City's financial management system records. Those assets received will be recorded as capital, controlled or expensed. The Controller's Office is working with the departments to ensure that the method used will produce the required results.

5. Depreciation Expense

Finding: The initial capital asset roll forward schedule did not break out the removal of accumulated depreciation for retired assets separately from depreciation expense for the governmental activities. The roll forward and ultimately the conversion of the governmental funds to the government wide level were materially adjusted to properly break out depreciation expense.

Background: The City currently calculates depreciation expense as the difference between accumulated depreciation at the end of the year versus accumulated depreciation at the beginning of the year, while not taking into consideration the effects of retired capital assets in which the

accumulated depreciation should be taken off the books. Such calculation produces an environment in which depreciation expense and gain/loss on disposal of assets can be miscalculated.

Recommendation: Research the way in which information can be extracted from GFAMS to ensure that amounts being booked as depreciation expense are properly supported and accumulated depreciation for assets retired is removed separately.

Management Response: F&A fixed asset staff and Information Technology Department (ITD) staff will work with the GFAMS vendor to produce report enhancements to properly break out depreciation schedules as required by the new standards. The AIMS fixed asset system utilized by PWE and Solid Waste properly breaks out depreciation by individual asset.

6. Construction-In-Progress Depreciation

Finding: At year end, certain construction-in-progress (CIP) jobs are temporarily reclassified from CIP to a particular asset category; however no depreciation is taken on the asset. Depreciation expense is caught up in the year in which the asset is permanently transferred to the applicable capital asset category, resulting in an overstatement of depreciation expense in the year of catch-up and an understatement in prior years when the asset is temporarily reclassified. This resulted in a restatement of prior year financials and current year adjustments.

Recommendation: Depreciation expense on such assets should be estimated at year-end to more properly reflect the expense in the correct period.

Management Response: PWE's Asset Management Group will modify its procedures to ensure that all capital projects accrued at year-end will have the appropriate depreciation expense recorded. The expense will be adjusted to actual in the year the asset is capitalized.

7. Land Reconciliation

Finding: The City does not have procedures in place to ensure that values recorded for land in GFAMS and AIMS can be reconciled with land data tracked and recorded in the City's Real Estate Department.

Recommendation: The City should be reconciling information recorded as the land of the City, to the information encompassed in GFAMS and AIMS.

Management Response: F&A's and PWE's asset management groups will work with the PWE's Real Estate Section to establish and implement procedures that ensure all transactions related to Land are properly recorded in GFAMS or AIMS and that data/reports from both systems can be reconciled to the original source data.

8. Land Sales

Finding: Proceeds from land sales were recorded on the books and records; however, the land value was not removed from capital assets resulting in a restatement of the prior year financial statements and current year adjustments.

Recommendation: The City should be reconciling information recorded as the land of the City, to the information encompassed in GFAMS and AIMS to ensure that land sold is communicated to those responsible for maintaining the GFAMS and AIMS systems.

Management Response: F&A and PWE asset management groups will work with the PWE Real Estate Section to establish and implement procedures that ensure all transactions related to Land are properly recorded in GFAMS or AIMS and that data/reports from both systems can be reconciled to original source data.

9. Donated Assets

Finding: The City does not have a process in place to ensure that donated assets from developers and others are properly reflected and recorded in the general ledger of the City.

Background: The City is capturing operational information related to some of the donated assets to the City (i.e. water and sewer pipes that are transferred to the City by developers, streets which are turned over to the City for future maintenance), but is not ensuring that such operational information is generating proper accounting entries for financial reporting purposes. The lack of capturing this information resulted in material adjustments being recorded in the current year as well as restating prior year's financial statements.

Recommendation: Perform an analysis of areas in which the City accepts donated assets. After identification, the City needs to ensure that such donated assets are properly recorded in the general ledger of the City.

Management Response: PWE has developed procedures to ensure that donated assets will be reviewed and captured as an asset each year.

10. Construction-in Progress

Finding: The City had a large number of capital projects classified CIP, for which the balance had not changed in at least one year. By not properly removing projects, which are substantially complete out of the CIP category and into the proper capital asset line item, the City could overstate capitalized interest and understate depreciation expense.

Background: In the Water & Sewer fund we noted over \$300 million of projects that were classified in CIP at June 30, 2003, that were included in CIP at June 30, 2002.

Recommendation: The City should perform a thorough review of projects classified as CIP and remove those projects that have been placed into service to ensure that depreciation expense and capitalized interest calculations can be properly recorded.

Management Response: The current City Fixed Asset Policy requires that a CIP project be capitalized upon acceptance by City Council. The City will modify the policy to capitalize CIP projects upon substantial completion. PWE will review CIP projects with no activity to determine if they are substantially complete and should be capitalized.

G. ACCOUNTS PAYABLE

Finding: There were numerous disbursements that qualified as accounts payable for the year ended June 30, 2003 that were not originally captured and recorded as such in the general ledger of the City.

Recommendation: The City should modify its policies related to capturing and recording accounts payable items to ensure that a proper cut-off is achieved at year-end.

Management Response: The Controller's Office is reviewing its current year-end policies and procedures as they relate to all accrual transactions and the established timelines for accounts payable transactions cut-off. These updated policies and procedures will be conveyed to the departments.

H. PENSION LIABILITIES

Finding: The City historically had not been recording pension liabilities in accordance with GASB Statement No. 27, "Accounting for Pensions by State and Local Government Employers", which resulted in a restatement of prior year balances as well as material adjustments in the current year.

Background: The City has three separate pension plans, which cover Firefighters, Police and Municipal Employees. These pension plans had actuarially determined unfunded liabilities of approximately \$1.3 billion as of the actuarial date of July 1, 2002.

Recommendation: Record all pension liabilities in accordance with GASB Statement No. 27.

Management Response: The City worked with Deloitte & Touche LLP to record its assets and liabilities in accordance with GASB Statement No. 27 for FY03. We will continue to review the pension liability for all funds to ensure compliance with GASB Statement No. 27.

I. COMPENSATED ABSENCES

Finding: The City was not historically or currently recording compensated absences in accordance with the provisions of the compensated absence plan of the City. This resulted in a restatement of prior year balances as well as material adjustments to the current year financial statements.

Recommendation: Procedures need to be established and put in place to capture and record compensated absence information properly.

Management Response: The City is finalizing procedures to ensure that the compensated absence liability is reported correctly.

J. STALE BALANCES

Finding: The City has many balance sheet accounts in which the balances have not changed for over one year, even though the nature of the account would appear to warrant activity which would result in account balance changes.

Recommendation: The City should perform a detailed review and analysis of accounts with stale balances.

Management Response: The Controller's Office will perform regular reviews of accounts with stale balances to determine if any financial activities should have occurred and need to be reflected in the accounts.

K. ACCRUED PAYROLL

Finding: The City's payroll accrual was understated as of year-ended resulting in material adjustments to the current year financial statements.

Background: The City made a salary accrual at year-end, but it excluded certain large liability balances for overtime, part time salaries, premium pay and temporary employees.

Recommendation: Reevaluate the current process for booking payroll accruals to ensure that all costs associated with this accrual are considered in the recording for general ledger purposes.

Management Response: The City has reevaluated the current process for recording payroll accruals and is making revisions to the payroll system to account for the additional payroll costs as recommended by Deloitte.

L. DEBT

Finding: The City is not consistently capturing and recording all transactions related to the debt service of the City, which resulted in a restatement of the prior year financial statements and material adjustments to the current year books and records.

Background: The City is not capturing and reporting the financial transactions related to debt service of all funds on a consistent basis. It was noted that the recording of gains / losses on debt refundings as well as bond issuance costs were not being consistently applied between the various funds of the City.

Recommendation: Reevaluate the way debt transactions are accounted for and consider requiring the Debt Management Group of the City's Controller's Office to review and approve all entries made related to debt service obligations.

Management Response: The Controller's Office Debt Management group will work with the fund holders to ensure that our new debt bookings are consistent across the City. They will also provide information on the proper period for amortizing premiums, discounts, and deferred amounts.

M. NON-CASH TRANSACTIONS

Finding: Certain non-cash transactions were not properly reflected in the books and records of the City resulting in material adjustments to the current year books and records. The City entered into a lease agreement during the current year, which was not properly reflected in the general ledger of the City.

Recommendation: The City needs to establish procedures to ensure non-cash transactions are properly recorded and disclosed in the City's books and records.

Management Response: The Controller's Office financial reporting staff will meet regularly with departmental personnel. This will give the Financial Reporting staff the opportunity to learn of any current or pending non-routine accounting transactions and to work with the departmental personnel on various accounting issues. Also, the Financial Reporting staff will review all City Council actions to ensure that financial information is known and, therefore, can be accounted for properly.

N. UNRECONCILED CASH ACCOUNTS

Finding: A cash account related to the Sports Arena and others, which was reflected in the City's books and records, was not reconciled to transactions that occurred related to these activities resulting in material adjustments in the current year.

Background: The City has title to certain cash accounts that the City does not manage. The City does however receive monthly bank statements, which reports the balance and activity of these accounts. Such accounts for the Sports Arena, certain escrow accounts and others were not reconciled at year end, which resulted in both overstatements and understatements of cash.

Recommendation: All cash accounts managed outside of the City need to be monitored and reconciled on a monthly basis to the general ledger of the City to ensure proper recording in the books and records.

Management Response: All cash accounts managed outside of the City will be monitored and reconciled on a monthly basis to the general ledger of the City to ensure proper recording in the books and records.

O. WORKING TRIAL BALANCES

1. Standardization of Working Trial Balances

Finding: The City utilizes working trial balances to prepare its CAFR. We noted that the format for the working trial balances varied among funds. In addition, we noted certain mathematical errors, formula problems or hard coded numbers where formulas were expected which resulted in working trial balances not functioning as intended.

Recommendation: One standard working trial balance template needs to be utilized for all funds. Each working trial balance needs to be reviewed for mathematical accuracy.

Management Response: To the extent possible, the City will standardize all working trial balances and validate the appropriate sections.

2. Preparation of and Adjustments to Working Trial Balances

Finding: The City prepares its working trial balances based on the period 13 close. We noted that a significant number of adjustments posted by the City were required to the working trial balances.

Recommendation: The City should review its year-end closing process and evaluate the adjustments posted after the period 13 close to determine the cause of such adjustments and if such adjustments can be processed prior to the period 13 close.

Management Response: The City is reviewing its year end closing process and is evaluating adjustments posted after the Period 13 close to determine the cause of such adjustments and whether such adjustments can be processed prior to the close of Period 13.

P. CASH FLOW STATEMENTS

Finding: Cash flow statements were initially inaccurate and required significant revisions by the Controller's Office.

Recommendation: The City has a standard cash flow template which should be reviewed for consistency among all funds and training should be provided to employees who are responsible for completing these cash flow statements.

Management Response: The Aviation department used the cash flow model approved by the City's GASB34 conversion committee. The Controller's Office and Deloitte each changed one line in the non-cash section. The Aviation Department will continue to implement these changes in future years. Additionally, the City is reviewing the cash flow templates for consistency among all funds. Training will be provided to the fund holders on cash flow statement preparation, as needed.

Q. ACCOUNTS RECEIVABLE AND RELATED ALLOWANCE FOR DOUBTFUL ACCOUNTS

Finding: The City has a number of receivable accounts with known material uncollectible balances. The City has recorded an allowance against these uncollectible receivables; however the City does not have a written policy for determining the amounts or percentages necessary for an allowance for doubtful accounts.

Recommendation: The City should establish policies and procedures related to writing off old uncollectible receivable balances. In addition, the City should establish policies and procedures for calculating such allowances based upon historical experience.

Management Response: The Controller's Office is working with the City's Legal Department and F&A to determine what the City can do to resolve this issue, considering all statutory and regulatory requirements.

R. GASB STATEMENT NO. 34 CONVERSION

Finding: In accordance with GASB No. 34, the City is required to convert its governmental fund financial statements from the modified accrual basis of accounting to the full accrual basis of accounting. This conversion requires certain adjustments to the fund level financial statements. The City's conversion process appeared to be difficult for the City to perform. We noted that certain of the underlying tools utilized to perform the conversion were difficult to follow and required the City to create new tools.

Recommendation: The City should reevaluate the GASB No. 34 conversion process, create tools that are simple to follow and adequately document the conversion entries.

Management Response: The City has reevaluated the GASB No. 34 conversion process and is in the process of creating tools that will be simple to follow, and that adequately document the conversion entries.

S. BUSINESS CONTINUITY PLANNING

Finding: The City's disaster recovery plan has been documented. However, the plan has not been tested to ensure that it can be executed in the event of a disaster. In addition, the document is not comprehensive enough to ensure a true business continuity plan.

Background: No recovery tests have been performed since 1999 to ensure the recoverability of the system in the event of a disaster

Recommendation: Perform tests of the City's disaster recovery plan to ensure that it will perform as anticipated in the event of a disaster.

Management Response: A migration strategy to move most mainframe computer applications to client server technology is planned over the next three or five years. Disaster recovery plans will be included as part of this migration. In the interim, expedited contract recovery services will be utilized in the event of system outages.

T. WINDOWS AUDITING POLICY

Finding: The local audit policy setting has not been activated to record any security event or incident; therefore there are no records of security violations.

Recommendation: Activate the local audit policy setting related to Windows to enhance the capability of detecting and documenting security violations.

Management Response: The City's Systems Services Group of the Information Technology Department has configured the Windows auditing function for the Finance & Administration Department to the recommended settings from the external auditors.